The Pakistan Credit Rating Agency Limited

NATIONAL BANK OF PAKISTAN

	INITIAL [JUNE-15]
Entity	
Long Term	AAA
Short Term	A1+
Outlook	Stable

REPORT CONTENTS

JUNE 2015

Rating Analyses
(June 2015)

NATIONAL BANK OF PAKISTAN (NBP)

RATING RATIONALE

The ratings reflect NBP's strong sponsor - Government of Pakistan (GoP) - and its deposit guarantee under the Banks (Nationalization) Act, 1974. On a standalone basis, NBP maintains a sound financial profile, an outcome of strong equity base, healthy liquidity, and good profitability. The bank's diversified deposit base benefits from its strong franchise and wide spread network. However, over the recent years, the banks system share has reduced; requiring the management to nurture a specific strategy herein. The bank has lately started focusing on Islamic Banking (IB) through window operations. Relatively constrained credit profile of NBP (high level of NPLs) is a key challenge - overseas operations and domestic private credit are key contributors. Thus strengthening of related risk management systems is important. Meanwhile, technology infrastructure requires up-gradation for effective support to decision making. The management expects wide-scale implementation of new core banking application - Profile - in CY15.

KEY RATING DRIVERS

NBP strategy is to i) reduce overseas losses, ii) enhance technological framework, iii) expand offerings to support deposit expansion, and iv) overcome asset infection. All these should bring stability - indeed improvement - in performance. A dynamic strategy, and a stable and committed team remain key pre-requisites. Given public sector banking institution, government intervention beyond the controls of BoD, thereby impacting overall governance framework, may negatively impact the ratings.

- **Advances Composition and Concentration:** NBP is the largest lender in the country with ~17% share in commercial banking industry's advances at end-CY14. The bank's earning assets – mainly comprising advances and investments – constitute 89% of total assets. Out of the total lending portfolio, 9% represents overseas exposure. During CY14, NBP's gross loan portfolio increased nominally (~3%) despite sizable growth (11%) in customer deposits. This led to a rationalized ADR (CY14: 51%; CY13: 56%). Public sector lending represented 35% of the total book at end-CY14. Overall advances concentration in terms of top-20 private sector performing group exposures is low. Top-3 sector exposures remained same (37%) YoY, with major lending to energy (18%), followed by transportation (~11%), and textile (9%) sectors.
- **Credit Risk:** The bank's asset quality is considered weak. Overseas portfolio witnessed a significant increase in fresh NPLs – mainly due to Bangladesh operations, taking the overseas book infection to 47% at end-CY14 (end-CY13: 27%). Recoveries from domestic NPLs diluted its drag on overall infection (end-CY14: 18%, end-CY13: 16%). Nevertheless, NBP's NPLs from domestic operations are high at 14% (end-CY14). A disection of these NPLs to private sector highlights real weakness with private sector infection ratio being 26% (end-CY14). Moreover, a sizeable exposure in public sector lending comprises loans to financially weak entities. As most of these are secured against government guarantees, the bank enjoys exemption from their classification. Nevertheless, the bank has coverage of 84% against classified portfolio at end-CY14 – slightly better than industry.
- **Market Risk:** The bank's investment portfolio increased by 43% during CY14. Share of Government Securities grew to 83% (end-CY13: 76%). The bank also maintains sizeable equity portfolio (9%), fixed income funds (6%) and strategic investments (2%). During CY14, government securities mix witnessed a significant shift towards PIB: 70% (CY13: 28%) in line with the industry. This exposes the bank to interest rate risk.
- **Funding and Liquidity:** NBP's funding base – predominantly comprising customer deposits (84%) – continued to strengthen during CY14. However, on a medium-term time line basis, NBP is loosing to its peer (system deposit share CY11: 16%, CY14: 12%). The bank needs to pay attention here. Top 20 depositor's concentration declined (end-CY14: 18%, end-CY13: 23%). NBP maintains healthy liquidity (end-CY14: 59%).
- **Capital:** NBP is strongly capitalized, as depicted from 17% CAR at end-CY14.
- **Performance:** During CY14, NBP's interest revenue witnessed an increase of 15% on YoY basis mainly due to sizeable increase in investment in high yielding PIBs. Although, the bank's cost of funds increased mainly on account of higher proportion of savings accounts, the improvement in the yield helped in largely maintaining the spreads. Sizable contribution from non-markup income – a factor of gain on sale of investments – augemented the revenue base. Despite rise in non-markup expenses, cost to total net revenue slightly improved (CY14: 59%, CY13: 62%); though still higher than peers. Provisioning expense declined. Hence, despite substantial loss in overseas operations, the bank managed to post YoY higher profits (PKR 15bln) – normalized to its recent average achieved in last few years. The bank's realization of sizeable gain on sale of PIBs helpd in generating healthy profitability during 1QCY15.
- **Strategy:** NBP intends to maintain its industry positioning. The focus is to i) reduce overseas loses, thereby strengthening bottom-line performance, ii) improve asset quality – particularly in Bangladesh operations for which focused efforts are underway, iii) enhance technological framework – implementing core banking application across the bank, and iv) expand offering by focusing on Islamic Banking and Branchless Banking. However, owing to its large size and business volumes, key challenges remain effecitve implementation of risk management framework and structural inefficiencies.
- **Profile:** NBP is the largest public sector commercial bank with a deposit system share of 12% at end-CY14. The bank maintains a network of 1,376 (including 21 overseas) branches at end-Mar15. The Bank is majority (~76%) owned by GoP, through SBP.
- **Governance & Management:** Overall control of the bank lies with eight-member board. The President and six board members are directly nominated by GoP, while one director represents minority interest. Mr. Muneer Kamal, the Chairman, since early 2014, is a seasoned banker. Syed Ahmed Iqbal Ashraf, the President since Jan14, is supported by an experienced team.

National Bank of Pakistan (NBP)

PKR mln

BALANCE SHEET	31-Mar-15	31-Dec-14	31-Dec-13	31-Dec-12
Earning Assets				
Advances (Net of NPL)	582,290	607,223	592,398	638,103
Debt Instruments	8,551	7,519	4,614	6,589
Total Finances	590,841	614,742	597,012	644,692
Investments	588,176	551,294	385,937	330,041
Others	30,441	129,703	79,181	36,739
	1,209,458	**1,295,738**	**1,062,131**	**1,011,472**
Non Earning Assets				
Non-Earning Cash	130,133	92,165	148,145	160,089
Deferred Tax	9,911	9,878	10,955	9,848
Net Non-Performing Finances	30,580	22,433	30,429	23,495
Fixed Assets & Others	121,363	122,840	112,681	104,625
	291,987	**247,316**	**302,211**	**298,056**
TOTAL ASSETS	**1,501,445**	**1,543,054**	**1,364,341**	**1,309,528**
Interest Bearning Liabilities				
Deposits	1,136,353	1,233,525	1,101,139	1,036,739
Borrowings	98,883	37,554	22,019	51,326
	1,235,236	1,271,080	1,123,157	1,088,065
Non Interest Bearing Liabilities	99,357	93,646	84,897	81,482
TOTAL LIABILITIES	**1,334,593**	**1,364,725**	**1,208,055**	**1,169,548**
EQUITY (including revaluation surplus)	**166,851**	**178,329**	**156,287**	**139,981**
Total Liabilities & Equity	**1,501,445**	**1,543,054**	**1,364,341**	**1,309,528**

INCOME STATEMENT	31-Mar-15	31-Dec-14	31-Dec-13	31-Dec-12
	Quarterly	Annual	Annual	Annual
Interest / Mark up Earned	29,256	114,174	99,028	100,092
Interest / Mark up Expensed	(18,777)	(70,007)	(60,823)	(56,418)
Net Interest / Markup revenue	**10,479**	**44,166**	**38,205**	**43,674**
Other Income	8,464	31,472	25,570	23,849
Total Revenue	**18,943**	**75,639**	**63,774**	**67,524**
Non-Interest / Non-Mark up Expensed	(10,608)	(42,561)	(37,205)	(35,457)
Pre-provision operating profit	8,335	33,078	26,569	32,067
Provisions	(3,316)	(11,077)	(19,491)	(10,688)
Pre-tax profit	5,019	22,001	7,078	21,378
Taxes	(1,742)	(6,973)	(1,578)	(6,437)
Net Income	**3,277**	**15,028**	**5,500**	**14,941**

Ratio Analysis	31-Mar-15	31-Dec-14	31-Dec-13	31-Dec-12
	Quarterly	Annual	Annual	Annual
Performance				
ROE	12%	14%	5%	14%
Cost-to-Total Net Revenue	56%	59%	61%	55%
Provision Expense / Pre Provision Profit	40%	33%	73%	33%
Capital Adequacy				
Equity/Total Assets	7%	7%	7%	8%
Capital Adequacy Ratio as per SBP	17%	17%	15%	16%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	59%	58%	54%	46%
Advances / Deposits	54%	51%	56%	63%
CASA deposits / Total Customer Deposits	72%	73%	70%	73%
Intermediation Efficiency				
Asset Yield	10%	10%	10%	11%
Cost of Funds	7%	7%	6%	7%
Spread	3%	3%	4%	4%
Outreach				
Branches	1,376	1,377	1,365	1,306

The Pakistan Credit Rating Agency Limited

STANDARD RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

<table>
<tr><th colspan="2">LONG TERM RATINGS</th><th>SHORT TERM RATINGS</th></tr>
<tr><td>AAA</td><td>Highest credit quality. Lowest expectation of credit risk.
Indicate exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.</td><td rowspan="7">A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.</td></tr>
<tr><td>AA+
AA
AA-</td><td>Very high credit quality. Very low expectation of credit risk.
Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.</td></tr>
<tr><td>A+
A
A-</td><td>High credit quality. Low expectation of credit risk.
The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.</td></tr>
<tr><td>BBB+
BBB
BBB-</td><td>Good credit quality. Currently a low expectation of credit risk.
The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.</td></tr>
<tr><td>BB+
BB
BB-</td><td>Speculative. Possibility of credit risk developing.
There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.</td></tr>
<tr><td>B+
B
B-</td><td>Highly speculative. Significant credit risk.
A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.</td></tr>
<tr><td>CCC
CC
C</td><td>High default risk. Substantial credit risk
“CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.</td></tr>
<tr><td>D</td><td colspan="2">Obligations are currently in default.</td></tr>
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Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

Name of Issuer	National Bank of Pakistan
Sector	Banking
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment Regulatory Requirement

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
30-Jun-15	AAA	A1+	Stable	Initial

Related Criteria and Research

Rating Methodology — Bank Rating Methodology

Sector Research — Banking Sector - Viewpoint | Mar-15

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Rating Team Statement

Rating Procedure
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PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past